

Message Text

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44

ACTION ARA-20

INFO OCT-01 ISO-00 CIAE-00 DODE-00 PM-07 H-03 INR-10 L-03

NSAE-00 NSC-10 PA-04 RSC-01 PRS-01 SPC-03 SS-20

USIA-15 ACDA-19 IO-14 AID-20 COME-00 EB-11 FRB-02

TRSE-00 XMB-07 OPIC-12 CIEP-02 LAB-06 SIL-01 OMB-01

DRC-01 /194 W

----- 036994

R 051820Z NOV 73

FM AMEMBASSY BRASILIA

TO SECSTATE WASHDC 353

INFO AMCONSUL RIO DE JANEIRO

AMCONSUL RECIFE

AMCONSUL SAO PAULO

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E.O. 11652: N/A

TAGS: EGEN EFIN BR

SUBJECT: SKEPTICISM MOUNTS ON GOVERNMENT'S INFLATION TARGET

1. SUMMARY: PRESENT INDICATIONS ARE THAT GOB WILL MISS ITS HIGHLY PUBLICIZED TARGET TO CONTAIN INFLATION FOR THE YEAR TO A 12 PERCENT RISE, CAUSING EMBARRASSMENT BUT NOT A MAJOR SETBACK FOR THE MEDICI ADMINISTRATION. SERIOUS INFLATIONARY PRESSURES WILL CONTINUE TO CONFRONT THE CURRENT AND SUCCESSOR GOVERNMENTS AND A MAJOR PROBLEM IN THE FORESEEABLE FUTURE WILL BE THE NEED FOR ECONOMIC PROGRAM COMPATIBLE WITH DUAL OBJECTIVES OF HIGH GROWTH AND DOMESTIC PRICE RESTRAINT. END SUMMARY.

2. WHILE THE GUANABARA (RIO DE JANEIRO) COST OF LIVING INDEX CONTINUES TO REGISTER INCREASES COMMENSURATE WITH THE GOVERNMENT'S TARGET TO LIMIT THE INFLATIONARY RISE TO 12 PERCENT (AS MEASURED BY THAT INDEX) PRESS LIMITED OFFICIAL USE

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AND PUBLIC CRITICISM HAS BEEN GROWING THAT THE RIO INDEX

IS NOT REPRESENTATIVE OF COST OF LIVING TRENDS IN THE REST OF THE COUNTRY AND THAT THE ACTUAL RATE OF INFLATION IS MUCH HIGHER. THROUGH THE FIRST NINE MONTHS OF THE YEAR, THE RIO INDEX SHOWD A CUMULATIVE RISE OF 9.6 PERCENT. BELO HORIZONTE, THE THIRD LARGEST CITY, SHOWED A SIMILAR GAIN OF 9.9 PERCENT; HOWEVER, OTHER MAJOR CITIES REGISTERED LARGER CHANGES: SAO PAULO --11.1; PORTO ALEGRE--16.8; CURITIBA--21.5 (THROUGH AUGUST); AND BRASILIA--15.9 PERCENT. REPORTS FROM CITIES IN THE NORTH AND NORTHEASE INDICATE PRICE INCREASES DURING THE FIRST THREE QUARTERS WELL IN EXCESS OF 20 PERCENT. FOR ALL INDEXES ON WHICH SOME DETAILLED DATA IS AVAILABLE, THE STRONGEST INFLATIONARY PRESSURES HAVE COME FROM SKY-ROCKETING FOOD PRICES.

3. ALTHOUGH INDEX TRENDS IN PRINCIPAL CITIES SUCH AS SAO PAULO AND BELO HORIZONTE, AS WELL AS RIO, SHOW A DECLINING RATE OF INFLATION COMPARED TO 1972, "MAN IN THE STREET" REACTIONS TO RISING RETAIL PRICES AND UNOFFICIAL SURVEYS HAVE STIMULATED CONSIDERABLE PUBLIC DISCUSSION THAT THE DECLINING TREND IS MORE STATISTICAL THAN REAL. REPORTS FROM OTHER PARTS OF THE COUNTRY INDICATE THAT INFLATION IS ON THE RISE COMPARED TO 1972.

4. IN RECENT WEEKS, AUTHORITIES HAVE INCREASED EFFORTS TO ASSURE THAT YEAR-END RESULTS AT LEAST APPROXIMATE THE 12 PERCENT TARGET. MEASURES LARGELY FOCUS ON EFFORTS TO INCREASE SHORT-TERM SUPPLY BY RELEASING GOVERNMENT STOCKS AND LIBERALIZING IMPORTS OF KEY COMMODITIES, SPECIAL CREDIT AND HIGHER SUPPORT PRICES TO FARMERS, EXPORT RESTRICTIONS ON SCARCE FOOD PRODUCTS AND RAW MATERIALS, WAIVER OF INTERNAL TAXES ON MANY HIGH CONSUMPTION GOODS, FOREGOING OF RATE INCREASES BY PUBLIC UTILITIES, RIGOUROUS APPLICATION OF OFFICIAL PRICE CONTROLS, AND STRENUOUS JAW-BONING WITH SEVERAL WELL-PUBLICIZED INSTANCES OF PUNITIVE ACTION AGAINST COMPANIES NOT COMPLYING WITH GOVERNMENT DIRECTIVES.

5. THE AUTHORITIES HAVE EMPLOYED MONETARY POLICY, THROUGH OPEN MARKET OPERATIONS AND RESTRICTIONS ON THE INFLOW OF FINANCIAL CAPITAL FROM ABROAD, TO MAINTAIN CONTROL OVER THE DOMESTIC MONEY SUPPLY, ALTHOUGH THE INCREASE IN LIMITED OFFICIAL USE

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MEANS OF PAYMENT THROUGH AUGUST WAS 23 PERCENT, COMPARED TO 12.5 PERCENT FOR THE SAME PERIOD IN 1972. ADDITIONALLY, CONDITIONS IN INTERNATIONAL MARKETS, LEADING TO HIGHER PRICES AND SCARCITIES OVER WHICH LOCAL AUTHORITIES HAVE NO CONTROL, ACCOUNT FOR A LARGE MEASURE OF THE CURRENT INFLATION. BRAZILIAN PRESIDENT MEDICI RECOGNIZED THIS SITUATION IN A SPEECH TO THE NATION ON OCTOBER 30 WHEN HE LAID THE BLAME FOR RISING PRICES ON EXTERNAL CONDITIONS AND ON

DOMESTIC SPECULATORS WHO STOCKPILE GOODS IN ANTICIPATION OF HIGHER PROFITS. IN HIS SPEECH, HE ALSO IMPLICITLY WARNED THE COUNTRY THAT THESE UNFORESEEN CIRCUMSTANCES COULD PREVENT THE GOVERNMENT FROM MEETING ITS 12 PERCENT TARGET.

6. COMMENT: IT NOW SEEMS ALMOST CERTAIN THAT THE GOVERNMENT WILL NOT ACHIEVE ITS 12 PERCENT RIO COST OF LIVING TARGET BUT IT IS ALSO LIKELY THAT THE YEAR-END RESULT WILL NOT BE SO FAR ABOVE 12 PERCENT AS TO CAUSE SERIOUS QUESTIONING OF THE GOVERNMENT'S ECONOMIC MANAGEMENT. NEVERTHELESS, GOB POLICY MAKERS HAVE HAD A TASTE OF THE DIFFICULTIES THAT THEY WILL CONTINUE TO ENCOUNTER IN ATTEMPTING TO PURSUE THE DUAL OBJECTIVES OF HIGH GROWTH AND DOMESTIC PRICE RESTRAINT. RAW MATERIAL AND LABOR SHORTAGES, INCLUDING UNSKILLED LABOR, ARE RAISING THE PRICE TAG ON INDUSTRIAL EXPANSION. WORLD MARKET CONDITIONS FOR ESSENTIAL IMPORTS, PARTICULARLY PETROLEUM, INDICATE EVEN GREATER EXTERNAL INFLATIONARY PRESSURES (ALTHOUGH IT HAS TO BE NOTED THAT HIGH PRICES IN COMMODITY MARKETS HAVE BEEN A MAJOR STIMULUS FOR BRAZIL'S BOOMING EXPORT EXPANSION). A FURTHER CONSIDERATION AS TO HOW FAR GOB AUTHORITIES CAN BRING DOWN THE RATE OF INFLATION CONCERNS MONETARY CORRECTION, A KEY INSTRUMENT FOR GENERATING DOMESTIC INVESTMENT BUT ONE THAT CONTAINS A BUILT-IN INFLUENCE TO FEED INFLATIONARY EXPECTATIONS.

7. MUCH CRITICISM OF THE GOVERNMENT'S ANTI-INFLATION POLICIES HAS CATEGORIZED THOSE EFFORTS AS SPORADIC AND PIECEMEAL, AND IT IS CLEAR THAT AUTHORITIES ARE RELUCTANT TO EMPLOY BROADSCALE RESTRICTIVE MONETARY OR FISCAL POLICIES THAT COULD ADVERSELY AFFECT THE HIGHER PRIORITY OBJECTIVE OF SUSTAINING BRAZIL'S 10 PERCENT REAL GROWTH RATE.

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